



U.S. Peanut Sector Adapts to Major Policy Changes

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Until 2002, peanuts were among a small group of U.S. commodities regulated by marketing quotas. As with the tobacco and sugar programs, the peanut marketing quota program originated during the Great Depression as an effort to stabilize grower incomes with supply limitations. The result was higher prices for consumers. With the 2002 Farm Act, however, the longstanding peanut price support system was scrapped. As part of the new program, peanut quota owners received quota buyout payments, and peanut producers are now covered by the same set of supports—marketing loans, direct payments, and countercyclical payments—available to producers of many other program crops.

What pressures led to this striking change in policy and how have farmers fared since? What factors are smoothing, or complicating, the transition to a more market-oriented system? Although the circumstances of peanut producers are unique in many ways, their experience can offer insights for those contemplating similar policy changes for other crops, such as tobacco. (See box, "How Did the Old Program Work? Why Was It Changed?")

The longer term impacts of policy change are still playing out in the peanut sector, but some general observations can be made. First, average farm-level prices and planted acreage have declined compared with pre-2002 levels, but appear to be stabilizing. Second, with increased planting flexibility, peanut production is beginning to shift from some traditional, but less productive peanut-growing locations to higher yielding land. Third, for producers affected by the policy change, farm-level revenues have been bolstered by new sources of government revenue from the 2002 Farm Act, other sources of farm and off-farm income, and an upswing in domestic demand. Finally, producers are managing price risk

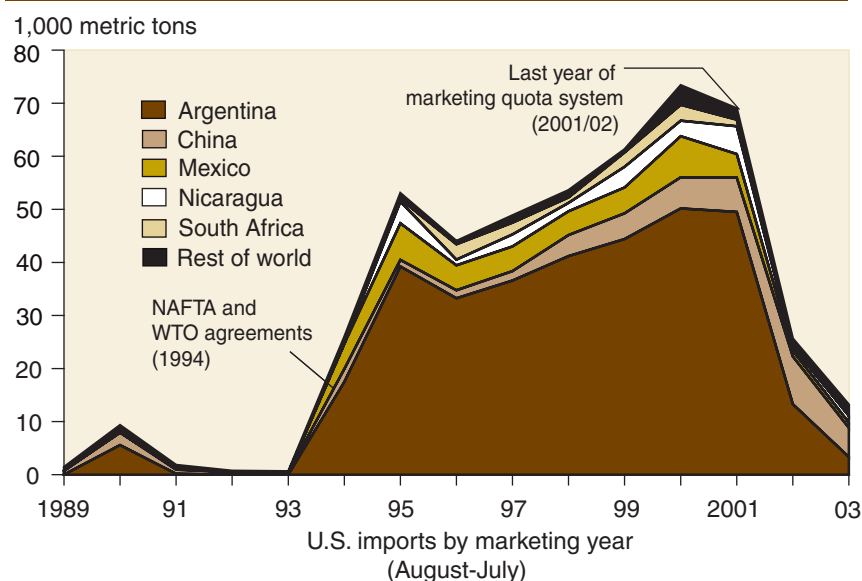
How Did the Old Program Work? Why Was It Changed?

Prior to 2002, the marketing quota system placed a limit on the amount of peanuts ("quota peanuts") that could be sold in the domestic market for food use (e.g., peanut butter, snacks, candy). Under this system, any peanuts produced beyond the quota level (so-called additional peanuts) had to be exported or diverted into the lower value crush market for oil and peanut meal. Producers who owned or rented quota rights were assured of receiving high prices based on a government-established "quota loan rate" of \$610 per ton during 1996-2001, with higher prices passed along to the consumer. This was well above average production costs, giving growers a strong incentive to produce the amount of peanuts allocated to them under the quota system. Producers not controlling quota rights were guaranteed an "additional" loan rate of only \$132 per ton, but they typically grew peanuts under contract for export at world prices (\$320-\$460 per ton), and responded primarily to demand in foreign markets.

Before 1994, annual peanut imports were capped by U.S. trade rules at a very low level, but in the mid-1990s, trade agreements signed by the U.S. began to gradually increase foreign access to the U.S. peanut market, and placed pressure on the marketing quota system. Under the peanut marketing quota system, import restrictions were needed to reserve the domestic market for higher priced quota peanuts. By undercutting the domestic support price, imports would have sharply reduced the share available to quota producers. As part of World Trade Organization negotiations, the U.S. established a tariff-rate quota (TRQ) system for peanuts, allowing lower-tariff peanut imports to rise to a current maximum of about 53,000 tons, about 6 percent of domestic consumption. A separate TRQ in the North American Free Trade Agreement will allow lower-tariff imports of Mexican peanuts to rise until 2008, and then become completely tariff-free. Mexico is a relatively minor peanut producer, but incentives to produce and export peanuts to the United States would have placed increasing pressure on the U.S. marketing quota program, as would potential new trade agreements.

Some observers suggest that recognition of these competitive pressures resulting from trade agreements—and the additional government resources made available to peanut producers in the 2002 Farm Act—facilitated acceptance of policy change by many growers.

Before the 2002 Farm Act, peanut imports had cut into the U.S. market



Source: USDA, Foreign Agricultural Service, U.S. Trade Internet System.

predominantly through the use of contracting and marketing associations.

Lower Prices Bring Reduced Plantings . . .

The relatively recent passage of the 2002 Farm Act makes it difficult to generalize about its impacts on individual peanut growers. Not surprisingly, though, the transition to the new policy environment has been marked by some uncertainty and adjustment pressures for U.S. peanut growers—a small but geographically concentrated group of farmers. For example, farm-level prices and market revenues dropped substantially following the 2002 Farm Act—particularly during the first year (2002) under the new policy. Farm revenues from peanut production fell from an annual average of about \$1 billion during 1996-2001, the period covered under the 1996 Farm Act, to just over \$600 million in 2002, but rebounded to nearly \$800 million in the 2003 marketing year (August-July). With the elimination of supply controls, producers who previously grew nonquota peanuts can now channel

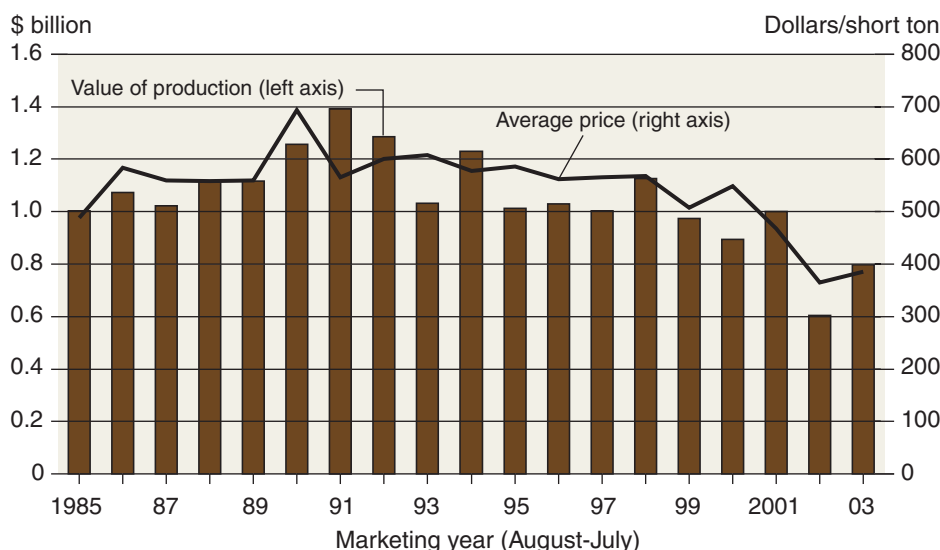
peanuts into the domestic market, pressuring farm-level prices down about 30 percent, from \$468-\$568 per ton during 1996-2001 to \$365-\$385 in 2002 and 2003.

Lower prices have, in turn, dampened production incentives, as indicated by 2 consecutive years of reduced U.S. plantings in 2002 and 2003. Although planted acreage remained stable in Alabama and Georgia and increased in Florida and South Carolina, other peanut-producing States reduced their acreage significantly. In Virginia and Oklahoma, plantings fell about 55 percent between 2001 and 2003; in Texas, they fell 35 percent. National plantings were the lowest since 1982 and second-lowest since 1915. However, plantings in 2004 were up 6 percent from 2003.

. . . But Some Producers Gain From Greater Flexibility

With the elimination of historical quota entitlements, less competitive peanut producers are now reducing output, most likely by switching to other crops. At the same time, production has

U.S. peanut producers faced declining prices and revenues following implementation of the 2002 Farm Act



Note: Data reflect farm-level prices. Prices prior to 2002 are a weighted average of quota and nonquota peanut prices.

Source: USDA, National Agricultural Statistics Service, Agricultural Statistics Database.

begun to expand in areas where—perhaps reflecting better growing conditions or management practices—peanut yields tend to be higher. This is not entirely surprising, as the old program may have hindered planting flexibility of peanut farmers. Under the old quota program, the high cost of acquiring quota rights and restrictions on transferring quota peanuts had concentrated production in areas originally granted quota acreage “allotments.” Starting in 1981, nonquota growers were allowed to produce peanuts anywhere they chose, but only for the lower priced export or crush market, which dampened their incentives to expand. In addition, high prices encouraged less efficient quota holders to continue producing peanuts, and it became costly or impossible for more efficient producers elsewhere to

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acquire quota rights and expand production. The majority of quota peanut production was by growers renting quota rights, but renting quota rights was expensive, equivalent to 25 percent of operating costs in 2001.

Since the 2002 Act, some peanut-producing areas—mainly in parts of the Southeast and western Texas—have significantly expanded acreage over their “base” plantings (peanut “base” refers to

producers’ average peanut acres planted during 1998-2001, which are used to determine, in part, government payments to farmers). In 2003, counties that planted more peanut acres than their peanut base saw an increase of at least 220,000 acres over the 1998-2001 average. The increases suggest that production has become more profitable in these areas following the elimination of restrictions on the domestic sale of nonquota. In areas with

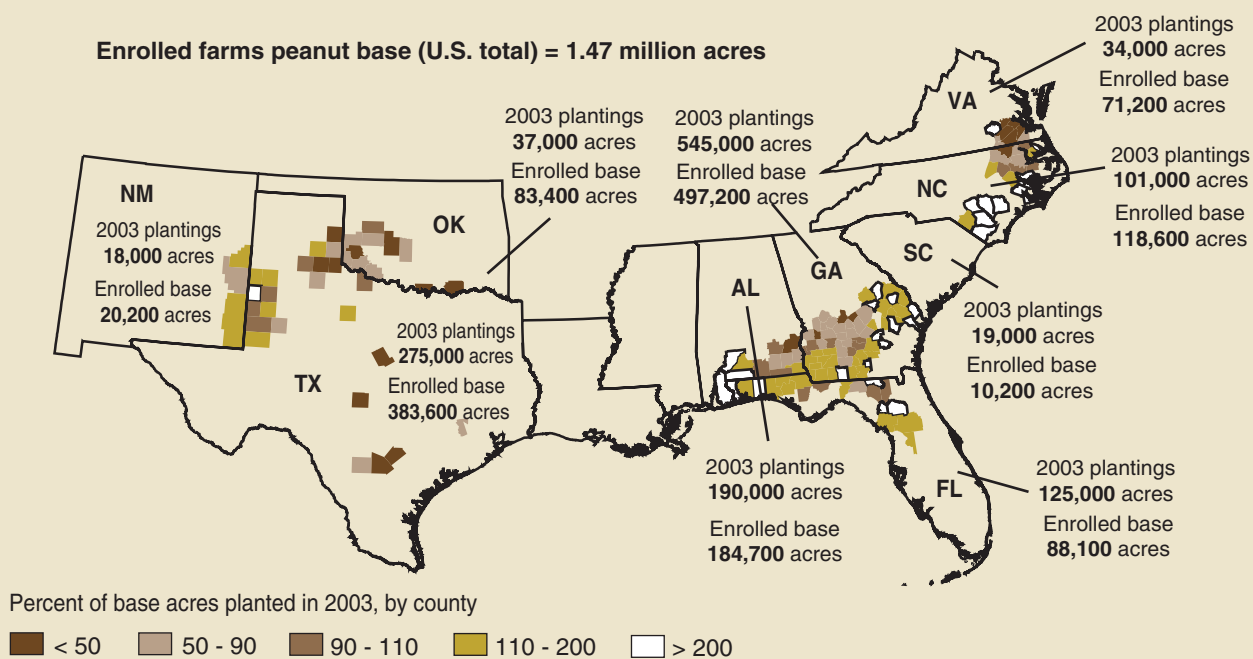
declining acreage, at least 25 percent of available peanut base acres were not planted to peanuts in 2003. Counties that gained acreage typically have better yields than counties where plantings fell, which could help explain the record national average yields achieved in 2003. Ultimately, program changes have spurred growers to base planting decisions more on expected market returns of competing crops, rotational considerations, and yield potential.

Other Income Sources Cushion Transition to New Program

The elimination of the marketing quota system clearly affected peanut growers in different ways. Inefficient farms that relied on the quota loan rate (support price) of \$610 per ton to cover production costs are on the wane. And despite lower average market prices, other more efficient producers—those who

Virginia, Oklahoma, and pockets of central Texas and Georgia have lost acreage, but other areas are thriving

Enrolled farms peanut base (U.S. total) = 1.47 million acres



Note: Base acres reflect average 1998-2001 historical peanut plantings enrolled under the 2002 Farm Act.

Sources: ERS calculations using NASS (National Agricultural Statistics Service), Agricultural Statistics Database and FSA (Farm Service Agency), USDA, data. Data not available for all counties.

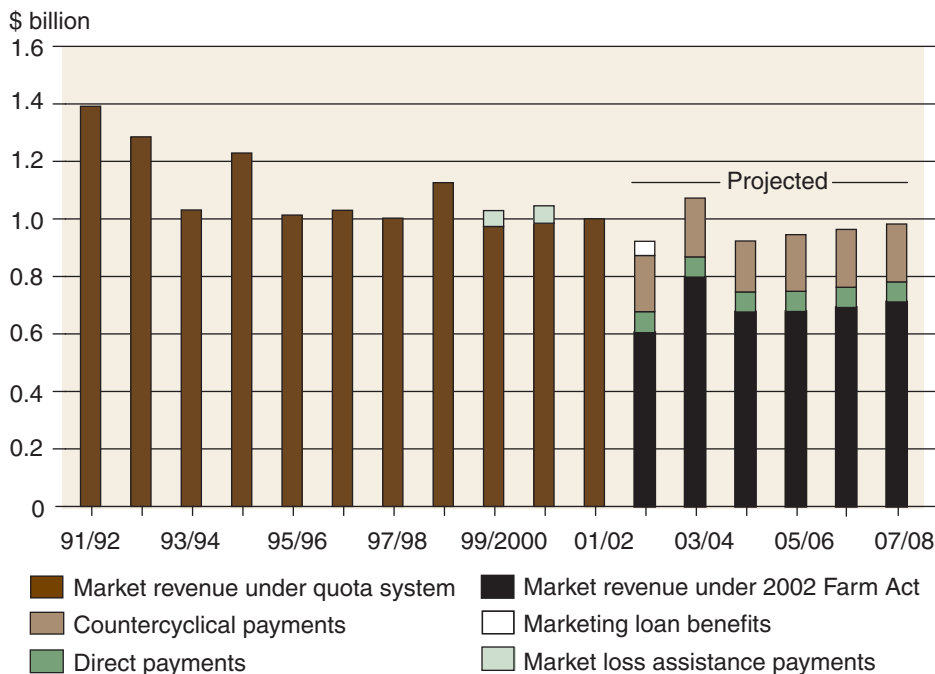
grew nonquota peanuts for export or now have lower costs since they no longer need to rent quota rights—are on the rise.

In either case, the economic impact of losing the quota system has been cushioned by several factors, including new sources of government revenue, off-farm income sources, and the relatively large and diversified structure of typical peanut farms (see box, "The Peanut Economy"). According to the President's fiscal year (FY) 2005 budget, for example, government payments to current and historical peanut producers with enrolled base acres would average \$275 million during 2002-07. Combined with projected market revenues (\$693 million annually), sector revenues would amount to \$968 million annually during 2002-07, about 5 percent

less than average revenues during 1996 to 2001. In addition to these government payments, persons owning a farm with peanut quota as of May 13, 2002, are eligible for a peanut quota buyout program. The buyout includes five annual payments of \$0.11 times the number of pounds of 2001 quota during FY2002-06—or the quota owner could opt for an equivalent lump-sum payment. A total of about \$1.3 billion is expected to be disbursed to nearly 70,000 eligible quota owners, with most having already taken their payment under the lump-sum option.

New sources of government payments include marketing loan benefits, direct payments, and countercyclical payments. For example, all peanut growers can receive marketing assistance loans of

Government payments boost projected peanut farm revenues to near recent average



Note: Peanut quota buyout payments not included. Data do not reflect government-paid storage and handling fees under the new program or cost savings associated with the elimination of quota rental payments.

Sources: 1991/92 - 2001/02: Farm Service Agency, National Agricultural Statistics Service (Agricultural Statistics Database), USDA; 2002/03 - 2007/08: Office of Management and Budget and World Agricultural Outlook Board, USDA.

The Peanut Economy

Peanuts are a relatively minor crop in the U.S. During the 1996 Farm Act (1996-2001), peanuts were grown on about 12,000 farms, averaging \$1 billion annually in peanut revenues—only 1 percent of U.S. crop production value. Due to the crop's soil and climate requirements, virtually all peanut production occurs in just a few States. The Southeast (Georgia, Alabama, Florida, and South Carolina) had 60 percent of national production during 1999-2001; the Southwest (Texas, Oklahoma, and New Mexico) had 28 percent; and the Mid-Atlantic (Virginia and North Carolina) had 12 percent. In Georgia and Alabama, peanuts accounted for over 20 percent of total State crop value in 2000/01-2001/02, but the peanut share of production value was lower (2 to 7 percent) in the other States.

According to the 2002 Agricultural Resource Management Survey (ARMS), peanut farms tend to be larger than average farms in peanut-growing areas—averaging 676 acres of cropland—and are fairly diversified. Peanuts are typically grown in a 3- to 4-year rotation on farms that grow cotton, soybeans, corn, and wheat. Cotton is the most common crop alternative. Peanut acres averaged only one-fifth of cropland on peanut-growing farms, but peanuts provided nearly 30 percent of total crop revenue. Producers exiting peanut production would thus likely emphasize crops already grown on the farm, avoiding additional investments in equipment and skills to grow new crops.

ARMS data also show that peanut producers had comparatively high overall household (farm and off-farm) incomes, which averaged about \$77,000 in 2002. This was about 30 percent higher than average incomes for nonfarm households. Combined with a diversified farm enterprise, sources of off-farm income will likely help offset changes in revenue under the new program.



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\$355 per ton on current production. Farmers with peanut base are eligible for fixed direct payments of \$36 per ton, and countercyclical payments that, depending on market prices, could reach \$104 per ton. To receive direct and countercyclical payments, historical producers were required to establish peanut base acreage and payment yields on their farms, which most—covering about 96 percent of eligible land—elected to do. These payments are available even if the eligible farmer chooses not to produce peanuts, so a portion may go to farmers no longer growing peanuts. Direct and countercyclical payments equal 85 percent of the farmer's base acres times their recent yield history (payment yield) times the direct or countercyclical payment rate.

In crop year 2002, marketing loan benefits to peanut producers amounted to \$49.7 million, direct payments totaled \$73.1 million, and countercyclical payments came to \$195 million. Marketing loan benefits are not expected to contribute to peanut sector revenue during the remainder of the 2002 Farm Act since prices are expected to remain above the marketing loan rate, but annual direct and countercyclical payments are projected to be about the same as in 2002.

Outlook Optimistic as Demand Accelerates . . .

One clearly optimistic note for the peanut sector has been the rebounding demand for peanuts and peanut products in recent years. In fact, the estimated 10-percent growth of U.S. peanut consumption in 2003/04 was the fastest annual growth in more than a decade, raising food-use demand to record levels.

Despite the lower farm-level prices since 2002, it's not clear whether policy changes in the 2002 Farm Act or other factors are responsible for this demand growth. Since peanuts are affordable to begin with, the responsiveness of consumers to changes in prices is likely low. Plus, consumption growth had already been on an upward trend since the mid-1990s. At the same time, retail prices for peanut butter—the leading use for peanuts—are now starting to trend down after initially rising following passage of the 2002 Farm Act. It is also likely that increased advertising, the introduction of new products, and reduced input costs for peanut processors have boosted overall peanut demand. Of course, the popularity of high-protein low-carbohydrate diets hasn't hurt demand either. A July 2003 FDA ruling allowing packaged peanuts to contain "qualified health claims" associat-

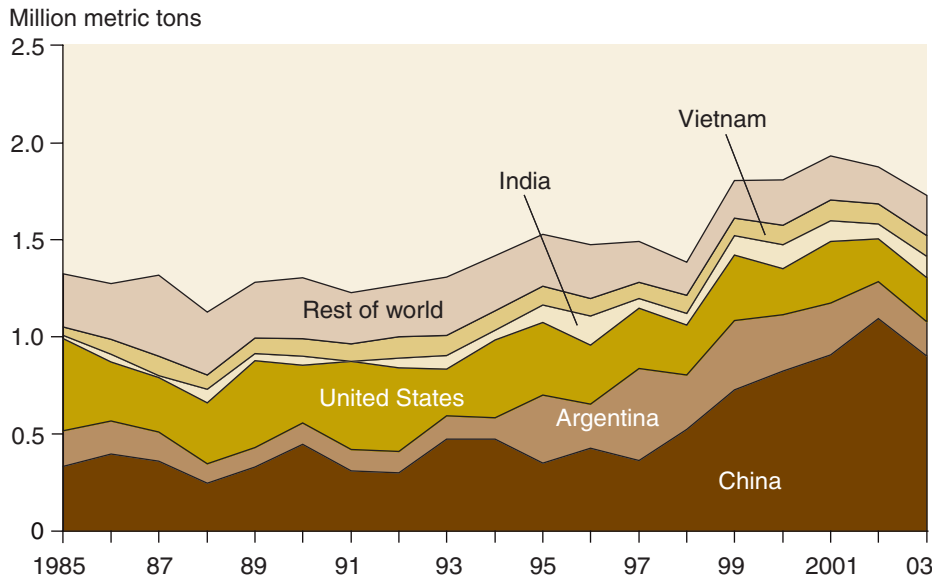
ing peanut consumption with reduced risk of heart disease could further this momentum.

While domestic demand has been rising, the outlook for U.S. exports looks less promising. "Additional" (nonquota) peanut producers had been exporting peanuts for decades, with exports typically accounting for 15 to 25 percent of U.S. production. A reputation for high quality has allowed U.S. sellers to command a price premium in international markets (primarily the European Union, Canada, and Mexico), but the U.S. has faced more competition from lower cost exporters of late. As a result, U.S. peanut exports have been on a downward trend since the early 1990s. China now controls more than half of global exports, with India, Argentina, and Vietnam significant too. Although the U.S. remains the world's second leading peanut exporter, the 2002 Farm Act may have weakened export incentives, as U.S. producers who grew nonquota peanuts for export can now market their peanuts domestically. On the other hand, lower domestic prices have reduced import incentives, and peanut imports have fallen by more than half since the 2002 Farm Act.

Limited Price Information Remains Challenging Issue for USDA, Peanut Growers

Under the marketing quota program, peanut prices had been determined directly by government policy for many years. But now, current and timely market price information for peanuts has become elusive due to the relatively small number of U.S. peanut producers and purchasers, sporadic sales, and the absence of a market exchange. This has posed challenges for policy implementation as well as for farmers' risk management strategies.

China has emerged as the world's leading peanut exporter



Source: USDA, Foreign Agricultural Service (PS&D online).

For example, the lack of consistent price information has complicated USDA's task of establishing the weekly marketing assistance loan repayment rate for peanuts—the market price barometer used to determine the level of potential marketing loan benefits. In addition, with fewer sources of price information, peanut growers also have fewer marketing options than producers of bulk com-

modities, who can spread risk by timing sales based on cash or futures prices. As a result, most peanut farmers are managing price risk by using government marketing loans and by entering into private marketing contracts with peanut buyers. Another option is to participate in one of the three Cooperative Marketing Associations that have been formed since 2002. These associations can process

marketing assistance loans on behalf of USDA and have the authority to market peanuts on behalf of their members—providing participants with increased flexibility and bargaining power.

Despite these complications, the major policy shift introduced by the 2002 Farm Act has increased the market orientation of the peanut sector. As peanut growers continue to adapt to the new environment, production decisions will increasingly be guided by demand conditions, as well as by growers' assessments of the relative profitability of producing peanuts compared with other crops. *W*

This article is drawn from . . .

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